

LOCAL INVESTMENT ADVISORY BOARD
915 Capitol Mall, Room 110
Sacramento, CA 95814

Minutes
September 24, 2003

William Sherwood, acting as Chairperson for State Treasurer Phil Angelides, called the Local Investment Advisory Board (LIAB) meeting to order at 1:45 p.m., Wednesday, September 24, 2003.

AGENDA ITEM 1: Roll Call

LIAB Members present were Patricia Elliott, Leslie Wells, and William Sherwood representing State Treasurer Phil Angelides. Byron Scordelis joined the meeting at 2:05 p.m. A quorum was present. The State Treasurer's Office staff present were Dan Dowell, Eileen Park, and Kim Lee.

AGENDA ITEM 2: Approval of the Minutes

The minutes of the June 5, 2003, meeting were approved as submitted with a motion by Ms. Elliott and seconded by Mr. Wells.

AGENDA ITEM 3: 2003 LAIF Annual Conference

Ms. Park briefed the Board Members on the 2003 LAIF Annual Conference program. She stated that the conference would be held at the Sacramento Convention Center on September 25, 2003, starting at 9:00 a.m. The final conference agenda was in the meeting binders. There were no speaker changes to the program.

Ms. Park reported that there were 159 individuals registered to attend the conference and 134 of these individuals were LAIF participants, representing 62 special districts, 27 cities, and 7 counties. She stated that approximately 38 percent of the registered attendees would be attending the conference for the first time. There were 52 individuals registered for the LAIF post conference tours at the State Treasurer's Office scheduled on Friday morning, September 26, 2003. A list of registered attendees for the conference and the post conference tours was available for review in the meeting binders. She further stated that the attendees included elected officials, oversight board members, and practitioners who deal with investment decisions and LAIF on a day-to-day basis.

Mr. Dowell stated that individuals from other state agencies as well as the Department of Water Resources would be attending the LAIF conference. These state personnel, after meeting with the Investment Division staff recently, determined the best way to get an overview of the PMIA was to attend the conference.

Ms. Park stated that the number of those attending the conference closely mirrors the participation in the LAIF program; 50 percent to 60 percent from the special districts, 16 percent from the cities, and 2 percent from the counties.

Mr. Wells asked if Bank of America representatives were attending the conference due to the service provided to the LAIF program.

Ms. Park confirmed that the conference was opened to private financial institutions that provide banking services to the program so that they can get an overview on how the program operates. Investment advisors that consult with the local agencies have also been allowed to attend the conference. Ms. Park stated that when financial institutions and consultants are more knowledgeable about the LAIF program, they might provide more knowledgeable service and advice to local agencies.

Mr. Wells stated that it was a good idea to open the conference to financial institutions as well as investment advisors. He further stated that there were a significant number of individuals from local agencies attending the conference considering tight budgets and economic conditions.

Ms. Park asked Mr. Wells to lead the audience with the Pledge of Allegiance at the conference. Ms. Park asked members if there were any questions regarding the upcoming conference.

Mr. Wells asked if staff addressed last year's criticism about speakers' handouts.

Ms. Park confirmed that handout copies were color prints and full size this year. She stated that the staff took the critique from last year seriously and great strides were taken to ensure presentation copies were done well. She further stated that in an effort to make the conference more interactive, space was provided on the registration forms to allow agencies to submit questions. There were only two questions returned with the registrations. Ms. Park said to further encourage an interactive program; sessions would be facilitated in the "talk show" format. The staff included color-coded sheets as a part of

the conference packets. These sheets would allow participants who may be too shy to participate on an open microphone to submit questions to the presenter. Ms. Park stated that two microphones would be available and circulating among the audience with the help of staff or Board Members while promoting discussion.

Ms. Elliott stated that the microphones for the audience would be helpful because often the speaker does not repeat the question.

Mr. Sherwood questioned if former LAIF Administrator Pat Beal would be attending the conference.

Ms. Park stated that Ms. Beal indicated that she would be attending the conference. Ms. Park further stated that an invitation is extended to Ms. Beal every year to attend the conference and staff always follow-up to solicit a response.

Mr. Sherwood stated that the work and preparation for the conference by the staff was always appreciated. He further stated that the time and effort put into the program makes it a worthwhile project. He thanked the staff for all the work, which make the conference a success.

Ms. Elliott stated that LAIF has been in existence for over 26 years and the conferences are very professional and get better each year. She stated that in spite of budget constraints, many participants are attending the conference because of their interest in the LAIF program and its operation as well as a desire to meet the STO staff.

AGENDA ITEM 4: Overview LAIF Operations and PMIA Performance

LAIF Operations

Ms. Park reported that as of September 24, 2003, the LAIF balance was \$21.2 billion, the daily rate for the program was 1.58 percent, and the average annual rate for fiscal year 2002/2003 was 2.152 percent. Ms. Park reported that she attended the California Special Districts Association (CSDA) Conference for one day. She stated that she made contact and had conversations with members of the CSDA as well as the president of Association of California Water Agencies (ACWA). Ms. Park further reported that she would attend the December 10, 2003, meeting of the Los Angeles division meeting for the California Municipal Treasurers Association (CMTA).

Mr. Sherwood asked Ms. Park to explain the difference in the LAIF balance over the last three months.

Ms. Park stated that the LAIF balance has gone from \$22 billion to \$21.3 billion because local agencies may be pursuing yield in other types of securities with other providers.

Mr. Dowell also stated that local agencies might need money operationally to a greater degree than in the past, since local agencies do not have the surplus money this fiscal year given the economic constraints.

Ms. Elliott agreed that local agencies' budgets are tight this year, but also some of the fund movement might be related to debt service for bonds. She stated that for her district, bond payments are due January 1, and July 1, as is the case with many local agencies. This may also be a reason for the fluctuation in the LAIF balance.

Mr. Wells stated that municipalities have been putting their funds to work in order to make it to the next tax increment. Some local agencies are holding funds in anticipation of the State Budget negotiations and there might be decreases in the LAIF balance as local agencies deal with those State Budget decisions. Mr. Wells stated that he has had conversations with several treasurers who still have concerns about the liquidity of the LAIF and the State Budget. Mr. Wells stated that he would also like to discuss two other issues. He stated that there has been concerns expressed about the 1) presentation given by CalTrust and 2) bonds that are being issued by the State of California for the tobacco settlement. He asked if the PMIA would be purchasing some of these bonds.

Mr. Sherwood stated that the issues with CalTrust and the tobacco bonds should be discussed under "Other Business" on the agenda.

Ms. Park stated that in a discussion with Ms. Bette Boatman, president of ACWA and director the Contra Costa Water District, she stated that there is still a lot of nervousness among the ACWA membership. She stated that LAIF representatives needed to talk to this group more often. Ms. Park assured Ms. Boatman that she and the investment managers are available to her membership for questions.

Mr. Wells stated that ACWA is the one organization where the boards of directors attend the conferences versus the financial representatives. The finance people are more knowledgeable about the LAIF program and its operation. In an effort to keep the ACWA membership and organizations like them informed, Mr. Wells suggested that LAIF work with CMTA, California Debt & Investment Advisory Commission, and others to provide educational programs for these groups.

Mr. Sherwood stated that full disclosure of LAIF operations is important. Local agencies are concerned with legislative actions and operations that have an effect on local governments and their budgets. Mr. Sherwood stated that because local agencies and the State Treasurer's Office can not control the legislative process, the PMIA maintains a level of liquidity during the annual State Budget cycle to address local agencies' concerns.

PMIA Performance

Mr. Dowell reported that the PMIA portfolio totaled \$51.9 billion as of today, September 24, 2003. The apportionment rate should be approximately 1.58 percent. The daily rate to start the new quarter would be approximately 1.58 percent, compared to the overnight rate outside the program in the market, which is at .98 percent to 1.00 percent. The 2-year Treasury Note was auctioned today at a 1.60 percent and the 3-year Treasury Note was trading at 2.07 percent. Therefore, the daily PMIA for overnight liquidity rate of 1.58 percent is between the 2-year and 3-year Treasury rate, which is a pretty-good rate for local agencies looking for liquidity. Mr. Dowell stated that on September 30, 2003, about \$2 billion will come into the Pool for the tobacco bond and at the end of October about \$3 billion will be received by the Pool from a revenue anticipation note sale. These two bond sales in the next 30 days should add about \$5 billion to the portfolio. Although Investments will be busy and short staffed due to long-term medical leave, cross training has been in process throughout the Investments Division and LAIF in order for each position to have back-up. Investments' staff have the technical ability to cover missing team members.

Mr. Sherwood stated that the Department of Finance has placed a freeze on state hiring due to the budget situation; therefore, the department would be unable to fill any position if it were to become vacant.

Ms. Elliott asked if the hiring freeze applied to the LAIF program when the program is self-supporting.

Mr. Sherwood responded that although the LAIF program is self-supporting, the program was still bound by the guidelines set forth by the State regarding the hiring freeze. The one LAIF position currently was not vacant because the individual was on maternity leave and could possibly return.

Mr. Dowell stated that the focus of his presentation at the conference would be to address the concerns from local agencies about the recall, the State Budget, and other issues. Mr.

Sherwood and he would speak at the conference on the past performances of the Pool and their estimates for the coming year. They would also discuss the liquidity and capability of the LAIF program and the responsibility of the participants for due diligence in determining their participation in LAIF.

Mr. Sherwood stated that the LAIF balance is currently at \$21.2 billion and was as high as \$22.5 billion in July. The fluctuation was probably due to the budget cycle. Mr. Scordelis asked if the local agencies were maintaining liquidity due to anticipated delays in receiving revenues from Sacramento for their programs or do the locals have a lack of confidence in the LAIF.

Mr. Sherwood responded that local agencies will keep more funds liquid outside the program and will additionally draw down their funds due to the uncertainty of the State Budget outcome and possible delays in State funding for programs.

AGENDA ITEM 5: Public Comment

There was no public comment for this meeting.

AGENDA ITEM 6: Other Business

Mr. Wells reported that CalTrust was an alternative investment program being marketed throughout the State at CMTA division meetings. Mr. Russ Gould is marketing CalTrust as a mutual fund. Mr. Wells further stated that there have been questions from a number of city treasurers and CMTA officers about the legality of CalTrust under local agencies' code for eligible investments. Mr. Wells stated that Mr. Gould has presented CalTrust as an alternative investment tool to LAIF for those looking for a short, intermediate, and long-term fund. The League of California Cities has co-partnered with CalTrust, although there were some concerns on the legal authority for this type of fund structure for local agencies.

Ms. Elliott stated that she first heard of CalTrust at a CMTA meeting. She further stated that as a treasurer, unless the fund is a permitted investment by government code, her district would not invest in the fund. Ms. Eillott stated that she did not see CalTrust as a competitor to LAIF but an investment alternative, as Mr. Sherwood suggested in the last board meeting.

Mr. Wells stated that he wanted to discuss CalTrust to ensure accurate information would be disseminated regarding the LAIF program.

Mr. Dowell stated that local government investment authority was separate from the PMIA investment authority. The State Treasurer's Office has traditionally remained neutral regarding the interpretation of government code for local governments unless that interpretation had an adverse impact on the PMIA operations. The State Treasurer's investment staff has never served in an oversight position for local governments' investment authority.

Mr. Sherwood stated that the investment staff does not recommend or review alternative funds. Mr. Sherwood stated that there are many programs like CalTrust and that the local agencies have their own attorneys and staff to research and interpret local government code. The State Treasurer's investment staff does not have the authority or background to determine the investment authority for local governments.

Ms. Elliott stated that while LAIF is not responsible for monitoring the CalTrust program, erroneous information given about LAIF during their presentations should be addressed.

Mr. Dowell agreed with Ms. Elliott's statement.

Mr. Wells suggested that CMTA might want to put together a panel presentation with LAIF and CalTrust.

Mr. Sherwood stated that for informational purposes, a panel presentation with LAIF and CalTrust would be an excellent idea. Mr. Sherwood stated that as Chief Investment Officer, he has known Mr. Gould for many years. He was a deputy at the State Treasurer's Office as well as the Director of the Department of Finance. Therefore, Mr. Gould has had a long-time relationship and knowledge of the PMIA program. Mr. Sherwood further stated that in the capacity as Chief Investment Officer, he has made comments during various speeches that diversification should be considered by local agencies. He stated that it is logical for local governments to have money in bank accounts to cover liquidity needs as well as investment accounts to cover intermediate and long-term needs. It is not the intention of the LAIF to be the only investment program for local agencies.

Mr. Wells stated that another issue of concern to some treasurers was the debt that would be issued by the State of California and whether the State or the State Treasurer's Office is directing that the bonds should be purchased with LAIF dollars for the PMIA portfolio.

Mr. Dowell stated that the investment staff has not purchased tax-exempt bonds for the PMIA portfolio. The staff would review and evaluate all eligible investments for the

PMIA portfolio as part of the standard procedure. The 10 to 30 year instruments such as tobacco bonds, pension bonds or any instruments of that nature are out of the maturity range for the PMIA as well as the scope of the PMIA's Investment Policy.

Mr. Sherwood asked Mr. Dowell to address the issue of liquidity for the Portfolio.

Mr. Dowell stated that the California bonds would not meet the Pool's policy requirement, which focuses on liquidity first. He stated that based on the PMIA's Investment Policy the bonds would not measure up to securities selected for the Portfolio.

Ms. Elliott stated that she would like to discuss a subject that was brought up at the last meeting, a general lack of trust in the State of California by ACWA and other groups, which in their minds translates to concerns about the safety of LAIF. Ms. Elliott stated that she thought it was very effective for Ms. Park and others from the investment staff to attend various meetings and answer questions. She stated that eventually the local agencies would build some level of trust in the LAIF program and become comfortable with the agencies' funds that were invested with the program. She further stated that if the local agencies were not able to attend the LAIF conference, then perhaps, Board Members and staff could attend some of the agencies' conferences in an effort to show willingness to talk about the program.

Mr. Sherwood stated that Mr. Dowell and his presentation about the makeup of the Portfolio as well as the safety and liquidity of the program would be discussed at the LAIF conference.

Mr. Dowell stated that LAIF dollars are trust monies and were not subject to be encumbered by the State. LAIF dollars are non-state trust monies that belonged to and were deposited by local agencies. Mr. Dowell explained that the State has the ability to divert legislated revenue monies before it reaches the local governments not LAIF monies.

Mr. Wells stated that Mr. Torrez brought this subject up in the last meeting. He stated that he thought that Mr. Torrez did not understand the difference between trust monies and legislated revenue. Mr. Wells stated that an explanation at the LAIF conference might make the association for the two types of monies clear to the attendees.

Mr. Scordelis asked if the law protecting LAIF dollars was well defined, in the event a court should intervene and secure funds. He further stated as a treasurer, he would want to ensure this situation would be addressed head on.

Mr. Sherwood stated that specific statutes provide that the State cannot borrow or seize LAIF monies for any purpose. The Treasurer has made it very clear that as their fiduciary he would protect LAIF should the legislature attempt to change the statutes to weaken the protection to LAIF. Mr. Sherwood further stated that however, since this office does not control the actions of the legislature or the courts, there is no ironclad guarantee when you are dealing with outside forces.

Mr. Dowell stated that he would be addressing these issues at the LAIF conference. He stated that he would also discuss the responsibility of LAIF participants to review LAIF's policies, procedures, and operations to determine confidence in the LAIF as a voluntary investment program.

Ms. Elliott stated that some of the concerns go back to the court injunction by the Jarvis group on July 22, 1998, when the State Controller's Office, based on their interpretation of the law did not issue warrants. The courts have since clearly issued its decision to permit the State Controller to issue warrants for investments and LAIF in the event there was no State Budget. Ms. Elliott stated that it was important that individuals that do not have day-to-day contact with LAIF understand these occurrences.

Mr. Dowell stated that he would address the subject at the LAIF conference.

Mr. Sherwood stated that the ACWA rumors proved to be misinformation. He said that this is an example why the staff say that we cannot guarantee or make absolutes because there is no way of knowing what the courts or the legislature might do.

Mr. Wells stated that it might be a good idea to extend an invitation to the presidents of other organization so that individuals might be informed of the LAIF operations. CSMFO and CMTA have adopted this practice in the past.

Ms. Park stated that she invited the president of ACWA as well as their entire board to the LAIF conference. She explained that the session on the LAIF's program on the operations and the management of the PMIA would address the ACWA members' concern.

Mr. Wells stated it is a very good idea to extend invitations to other organizations, especially ACWA. CMTA and CSFMO are fully involved but something needed to be done to involve ACWA.

Ms. Park stated that she would strive to maintain an open line of communication to these organizations.

AGENDA ITEM 7: Adjournment

There being no further business, the meeting was adjourned at 2:45 p.m.